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## REACHING THE GLASS USURY CEILING: WHY STATE CEILINGS AND FEDERAL PREEMPTION FORCE LOW-INCOME BORROWERS INTO SUBPRIME MORTGAGE LOANS

Anne Balcer Norton†

Consider Jane.<sup>1</sup> Jane inherited the deteriorating home that her parents owned on Baltimore's North Avenue for ten years. When the time comes for Jane and her three children to take possession of the home, the balance of her parents' first mortgage is \$33,000. She realizes that she needs to replace the broken hot water heater, repair the leaking roof, and fix several cracked windows. Jane is employed as a nurse's aid in a retirement home. She lives paycheck to paycheck, has no savings and does not know where to turn. The only lending institution in her neighborhood is "The Green Store," where she has received occasional "payday" loans. "The Green Store" is willing to grant her a mortgage loan for the \$11,000 needed for repairs but only if Jane agrees to refinance the entire mortgage of the home, pay off other unsecured debt, and take on a new first mortgage at "The Green Store's" assessed value of \$88,000. The monthly payments double, and the undisclosed fees and points that she is charged on the loan far exceed what she can truly afford. Nonetheless, following daily phone calls from the loan officer and without any other options, Jane agrees and authorizes the transaction.

The story of Jane is not unique; it is a scenario that low-income homeowners face in neighborhoods across the country.<sup>2</sup> Income level, race, and demographics have made subprime lending institu-

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1. The story of Jane is not a true story. "Jane's" circumstances are a compilation of those affecting the various clients that come to St. Ambrose Housing Aid Center in Baltimore, Maryland for loan default counseling and legal representation. See St. Ambrose Housing Aid Center, <http://www.stambros.org>.
2. Peggy Twohig, Prepared Statement of the Federal Trade Commission before the Board of Governors of the Federal Reserve System pt. 2 (Sept. 7, 2000), <http://www.ftc.gov/os/2000/09/Predatorylending.htm>.

tions, such as "The Green Store," the replacement for conventional banks in deteriorating communities.<sup>3</sup> Congress's enactment of the Depository Institutions Deregulation and Monetary Control Act<sup>4</sup> (DIDMCA), in 1980, promulgated the growth of such subprime lending.<sup>5</sup>

This Article will focus on subprime borrowers, specifically borrowers taking home equity or non-purchase money loans for their properties. Part I will examine the low-income borrower as a borrower in the subprime market and the prevalence of home equity lending therein. Part II discusses the predatory practices of numerous subprime lending institutions and the consequences of such practices. Part III outlines usury laws, specifically the laws of Maryland and Pennsylvania, enacted to protect vulnerable borrowers but negated by Congress's enactment of the DIDMCA. Part IV discusses strategies for shattering the iniquitous glass ceiling of usury laws.

## I. INTRODUCTION TO THE SUBPRIME BORROWER

### A. *Low Income Borrower as a Subprime Borrower*

Borrowers labeled as "high risk" are frequently barred access to loans at conventional rates<sup>6</sup> and are often steered into the arms of subprime lenders.<sup>7</sup> In many cases, accepting a subprime loan is the borrower's only access to credit.<sup>8</sup> These borrowers often have a high debt to income ratio, little to no credit history, or poor credit.<sup>9</sup> The majority of subprime borrowers share similar characteristics. Borrowers are from low- to moderate-income families living in the poorest census tracts.<sup>10</sup> Additionally, the majority of borrowers disproportionately come from minority groups.<sup>11</sup> Unfortunately, subprime bor-

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3. Borrowers who do not qualify for a "prime" rate mortgage loan, because of poor or damaged credit, are charged a higher rate "subprime" loan. Tania Davenport, Note, *An American Nightmare: Predatory Lending in the Subprime Home Mortgage Industry*, 36 SUFFOLK U. L. REV. 531, 532 (2003). Lenders in both markets assess a borrower's ability to repay the loan based on income, assets, and credit score when setting the rate charged. *Id.*
  4. Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in scattered sections of 12 U.S.C.).
  5. See *infra* notes 72-81 and accompanying text.
  6. The term "conventional rate" is being used to describe prime rates offered by conventional lenders.
  7. See Davenport, *supra* note 3, at 532.
  8. *Id.*
  9. *Id.*
  10. KENNETH TEMKIN ET AL., PREPARED FOR U.S. DEP'T OF HOUS. & URBAN DEV., SUBPRIME MARKETS, THE ROLE OF GSEs AND RISK-BASED PRICING 6 (2002) [hereinafter *HUD Study*], available at <http://www.huduser.org/Publications/pdf/Subprime.pdf>.
  11. *Id.* In fact, in 1998 the Department of Housing and Urban Development (HUD) found that "subprime loans accounted for 51 percent of the dollar amount of all refinance loans in predominantly black census tracts." *Id.*

rowers are typically uninformed.<sup>12</sup> Most are likely to respond to an advertisement or telephone call and few do preparatory research before entering into the transaction.<sup>13</sup>

### B. Why Low Income Borrowers Turn to the Subprime Market<sup>14</sup>

Borrowers, such as those described above, aspiring to purchase a home, make improvements to their home, or consolidate debt are often only able to receive a mortgage loan through a subprime lender. This is the case for several reasons. First, banks have fled at alarming rates from the neighborhoods where most subprime borrowers reside.<sup>15</sup> Second, it is my impression that conventional lenders are unable to make second mortgage loans (i.e., home equity loans)<sup>16</sup> to high

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12. THE REINVESTMENT FUND, MORTGAGE FORECLOSURE FILINGS IN PENNSYLVANIA: A STUDY BY THE REINVESTMENT FUND FOR THE PENNSYLVANIA DEPARTMENT OF BANKING 74 (2005) [hereinafter *PA Study*], available at <http://www.trfund.com/about/publications/pa%20foreclosures/Mortgage%20Foreclosure%20Filings.pdf>.
  13. *Id.* It is important to note that subprime lenders target certain borrowers through advertising in unconventional media, such as Ameriquest Mortgage's sponsorship of drag racing in Chicago, *Ameriquest Mortgage to sponsor fall Chicago event*, NAT'L DRAGSTER, March 18, 2005, at 4, [http://www.findarticles.com/p/articles/mi\\_qa4078/is\\_200503/ai\\_n13476006](http://www.findarticles.com/p/articles/mi_qa4078/is_200503/ai_n13476006), and Argent Mortgage's sponsorship of an Indy Grand Prix race in California, Infineon Raceway, Argent Mortgage Indy Car Grand Prix, [http://www.infineonraceway.com/news/argent\\_mortgage\\_indy\\_car\\_grand\\_prix/485487.html](http://www.infineonraceway.com/news/argent_mortgage_indy_car_grand_prix/485487.html) (last visited Nov. 11, 2005).
  14. Federal law exists to educate and assist borrowers to "shop around" and avoid unfavorable transactions prior to closing. Lenders must comply with the requirements set forth in the Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. §§ 2601-17 (2000), and the Truth in Lending Act (TILA), 15 U.S.C. §§ 1601-67f (2000). Unfortunately, the practical consequences of such legislation provide little assistance to the subprime borrower. The mortgage related disclosures required under the TILA are meant to offer the borrower the opportunity to shop around for a better transaction. This has little effect on a subprime borrower with little access to any other credit. Additionally, both RESPA and TILA are disclosure statutes and the information they require to be disclosed is only made available to the borrower shortly before closing. Kimm Tynan, *Pennsylvania Welcomes Predatory Lenders: Pennsylvania's Act 55 Preempts Philadelphia's Tough Ordinance But Provides Little Protection For Vulnerable Borrowers*, 34 RUTGERS L.J. 837, 867, 869 (2003); see, e.g., *Rendler v. Corus Bank*, 272 F.3d 992, 995 (7th Cir. 2001).
  15. This assertion is a brief introduction to the widespread problem of bank flight from the inner city. In many cases, these banks are replaced by check cashing facilities. I will not explore this idea in great detail, but it is a factor that must be mentioned when analyzing the growth of the subprime market. For a discussion of this problem, see, for example, Robert D. Bullard, Glenn S. Johnson & Angel O. Torres, *The Costs and Consequences of Suburban Sprawl: The Case of Metro Atlanta*, 17 GA. ST. U. L. REV. 935, 947-48 (2001); Alvin C. Harrell, Commentary, *The Case for Consumer Litigation, Part Two—Limitations of the Regulatory Alternative*, 52 CONSUMER FIN. L.Q. REP. 364, 402 (Fall 1998).
  16. For the purposes of this paper, "home equity lending" refers to loans, other than loans for purchase (nonpurchase money loans), that are lent on the

risk borrowers at a rate that falls within the prescribed usury rate for a given state.<sup>17</sup> Third, aggressive subprime lenders are willing to accept this allegedly higher risk in exchange for higher profit.<sup>18</sup> An additional characteristic of subprime lending worth discussion is that the majority of subprime loans are not lent based on the borrower's ability to repay, rather, many subprime loans are made solely because of the equity in the homeowner's home.<sup>19</sup>

### C. Home Equity Loans

Homeowners can borrow money leveraging the equity in their homes despite their income or creditworthiness. Borrowers may choose a home equity loan to make home repairs, essentially increasing the home's value, or consolidate other unsecured debt or make a major purchase, essentially stripping its value, based on available equity. A home equity loan is a second lien on a property; seventy-five percent of all subprime loans in 1999, however, were first liens.<sup>20</sup> As discussed in Part III, subprime lenders refinance the entire debt of both the mortgage and the additional expenditures into one first mortgage at a much higher cost to the borrower.<sup>21</sup> Not only will the borrower pay more over the life of the loan, but the subprime lender secures a first lien position on the borrower's home.<sup>22</sup> This presents a higher likelihood of the borrower losing the home to foreclosure in the event of default.<sup>23</sup> Borrowers unable to repay high rate first mort-

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equity in the borrower's home. A. Mechele Dickerson, *Bankruptcy and Mortgage Lending: The Homeowner Dilemma*, 38 J. MARSHALL L. REV. 19, 23 (2004). Traditionally, these loans take the form of a second lien on the property and are, therefore, referred to as a second mortgage. While researching this topic, I found that the terminology "home equity loan" or "second mortgage loan" have different meanings within different industries. For example, mortgage brokers and lenders define "home equity loans" broadly to include "home equity lines of credit," "debt consolidation," or "home improvement loans," specifically. Most professionals in the mortgage industry do not consider a refinance loan a home equity loan or a second mortgage loan because refinance loans take the form of a first mortgage lien.

17. See *infra* Part III.

18. Abraham B. Putney, *Rules, Standards, and Suitability: Finding the Correct Approach to Predatory Lending*, 71 FORDHAM L. REV. 2101, 2105 (2003).

19. Elizabeth Laderman, *Subprime Mortgage Lending and the Capital Markets*, FRBSF ECONOMIC LETTER, No. 2001-38 (Research Dep't, Fed. Reserve Bank of S.F., S.F., Cal.), Dec. 28, 2001.

20. *Id.* at 1. As discussed *infra* Part III, a first lien on a property is exempt from state usury limits under the DIDMCA.

21. See *infra* notes 81-87.

22. See *infra* Part III.C.2.

23. See *infra* note 30. See, for example, *PA Study*, *supra* note 12, at 1, for a discussion relating to the likelihood of purchase money loans to end in foreclosure.

gage loans can do little to cure the delinquency.<sup>24</sup> The lender, securing a first lien position, can immediately foreclose on the debtor's home and seize its securitized asset.<sup>25</sup>

The threat of foreclosure is real.<sup>26</sup> When borrowers refinance a lesser second mortgage into a first mortgage through a subprime lender, the monthly payment becomes greater, perhaps far in excess of what it would have been to maintain two separate loans.<sup>27</sup> Furthermore, because the borrower was most likely approved for the loan because of the home's equity, the borrower may not be able to repay the debt at all.<sup>28</sup> At that point, all of the borrower's debts, both secured and unsecured, put the homeowner in jeopardy of losing her single largest asset—her home.<sup>29</sup>

## II. PREDATORY PRACTICES OF SUBPRIME LENDING<sup>30</sup>

The mortgage transaction is one that is highly complicated for even the savviest consumer.<sup>31</sup> Aggressive sales tactics and a total disregard for the borrower's ability to make future payments are characteristics of predatory lending.<sup>32</sup> Subprime lenders, like conventional lenders,

24. See Elizabeth Renuart, Staff Attorney, Nat'l Consumer Law Ctr., Testimony Before the Board of Governors of the Federal Reserve Regarding Home Equity Lending and HOEPA (Aug. 4, 2000), available at [http://www.nclc.org/initiatives/predatory\\_mortgage/content/hoepa\\_fl\\_content.html](http://www.nclc.org/initiatives/predatory_mortgage/content/hoepa_fl_content.html). But see 24 C.F.R. § 203.355 (2005). HUD affords borrowers with Federal Housing Authority (FHA)-insured loans additional protections prior to foreclosure. *Id.* HUD further has the authority to modify or mitigate the foreclosure of FHA-insured loans. See U.S. DEP'T OF HOUS. & URBAN DEV., HANDBOOK 4330.1 REV-5, para. 8-1 (1994), available at [http://www.hudclips.org/sub\\_nonhud/cgi/hudclips\\_run.cgi?hudclips\\_run](http://www.hudclips.org/sub_nonhud/cgi/hudclips_run.cgi?hudclips_run) (follow "Chapter 8. HUD-Approved Relief Provisions" hyperlink).

25. See Laderman, *supra* note 19, at 1.

26. See *infra* note 51 and accompanying text.

27. See *infra* note 51 and accompanying text.

28. See Davenport, *supra* note 3, at 543.

29. See *id.* As a result of the new loan, previously unsecured debt or consumer purchases that could have been repossessed are now secured by the borrower's property.

30. Harold Levine, *A Day in the Life of a Residential Mortgage Defendant*, 36 J. MARSHALL L. REV. 687, 688 (2003) ("Predatory Lending" has been described as a catalog of onerous lending practices often targeting vulnerable populations and resulting in devastating personal losses, including bankruptcy, and the loss of people's home."); see also Ronald H. Silverman, *Toward Curing Predatory Lending*, 122 BANKING L.J. (SPECIAL ISSUE) 483, 495 & n.34 (2005). But see Davenport, *supra* note 3, at 533 ("Not all subprime loans are predatory, and not all subprime lending practices are unfair or abusive."). The higher rates, prepayment penalties, and default provisions associated with subprime loans exist to protect the lender taking a higher risk in extending the loan. Furthermore, "a subprime lender can assist a borrower in purchasing a home or in refinancing for home repairs or consumer credit debt reduction when prime lenders would refuse to do so." *Id.* at 532-33.

31. Putney, *supra* note 18, at 2104 & n.17.

32. Putney, *supra* note 18, at 2105.

offer a wide range of products from loans for purchases or refinancing, to home equity lines of credit and home improvement loans.<sup>33</sup> Unlike conventional lenders, though, the rates offered by subprime lenders vary substantially.<sup>34</sup> The lack of underwriting standards or reporting guidelines for subprime lenders culminates in this variance.<sup>35</sup> Additionally, current interest rates and points for particular loans available in the conventional market are published widely in print and electronic media.<sup>36</sup> In contrast, subprime lenders provide rate sheets that are only available to mortgage brokers, the terms of which change quickly, and at times, these tables are protected from public dissemination as “trade secrets.”<sup>37</sup>

Not all subprime lenders are predatory lenders.<sup>38</sup> Without consistent regulatory oversight, it is difficult to track the particular lenders that prey on the vulnerable.<sup>39</sup> Predatory loans are characterized as those in which the borrower is charged excessive rates, despite the borrower’s favorable credit; high fees, including hidden fees and “kickbacks”;<sup>40</sup> as well as lofty discount points.<sup>41</sup> Four other abusive practices<sup>42</sup> are loan flipping,<sup>43</sup> loan packing,<sup>44</sup> equity stripping,<sup>45</sup>

33. See Cathy Lesser Mansfield, *The Road to Subprime “HEL” Was Paved With Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. REV. 473, 557-58 (2000).

34. *Id.* at 535.

35. *Id.* at 559.

36. See, e.g., *The Baltimore Sun Mortgage Guide*, BALT. SUN, Feb. 19, 2006, at 11L (providing a weekly print statement of mortgage interest rates).

37. See *PA Study*, *supra* note 12, at 74.

38. See *supra* note 30.

39. See Davenport, *supra* note 3, at 552.

40. See Mansfield, *supra* note 33, at 534-35.

41. “Discount points are a percentage of the loan paid up front by the borrower and are typically associated with a buy-down of the interest rate.” Paul Hendry II, Comment, *Home Equity Lending in Texas: Are Loan Origination Fees Interest?*, 10 TEX. WESLEYAN L. REV. 259, 365 (2003). These points are nothing more than a bonus to the lender.

42. See Davenport, *supra* note 3, at 534; see also U.S. DEP’T. OF HOUS. & URBAN DEV. & U.S. DEP’T. OF TREASURY, CURBING PREDATORY HOME MORTGAGE LENDING 2 (2000), available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf>.

43. Davenport, *supra* note 3, at 542 (“Loan flipping occurs when a lender forces a borrower to refinance a loan repeatedly over a short period of time. A borrower is especially vulnerable to loan flipping when in danger of foreclosure . . .”). Unfortunately for the borrower, “[e]ach time the lender flips the loan, the lender charges additional fees, prepayment penalties, [and] closing costs . . .” *Id.* For a discussion of loan flipping that results from borrowers holding balloon notes, see Silverman, *supra* note 30, at 499-500.

44. Loan packing occurs when a lender “adds unnecessary charges and services to the loan amount without the borrower’s understanding or consent. Packing often entails charging additional fees for services such as life, disability, or credit insurance . . . unrelated to the original loan. . . .” Davenport, *supra* note 3, at 542.

45. Equity stripping occurs when the lender:

and fraud.<sup>46</sup>

Unlike the subprime market, the prime mortgage market acts as one of almost self-regulation.<sup>47</sup> Published rates and high competition keep costs and fees for borrowers low.<sup>48</sup> Accordingly, default rates are lower.<sup>49</sup> These self-regulatory-type protections are less prevalent within the subprime market.<sup>50</sup> Consequently, foreclosure has proven to be a natural consequence of subprime lending.<sup>51</sup> Conventional loans foreclosed at a rate that was 1/12 of that of subprime loans during the second quarter of 2003.<sup>52</sup> Recently, in Pennsylvania, 60-75% of the sampled loans that were in foreclosure were originated by subprime lenders.<sup>53</sup>

In a letter dated December 1, 2003, from the National Consumer Law Center to Chairman Michael Oxley of the House Financial Services Committee entitled "The Skyrocketing Foreclosure Rate Caused by Subprime Mortgages," Managing Attorney, Margot Saunders, stated:

[F]oreclosures are increasing over the long term—not quarter to quarter, but each year. The [Mortgage Bankers Association] is taking the position that mortgage lending that leads to high foreclosure rates is acceptable because it is known to be high risk. We are challenging the acceptability of this point. At what point does lending which stands a high risk of causing the loss of a family's home become unacceptable? . . . Should it be legal for mortgage lending to be permitted with the anticipated risk that the family will stand a 20% chance of losing its home?<sup>54</sup>

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'strips' the equity in the borrower's home by making a loan based solely on the amount of equity in the home rather than on the borrower's ability to repay the loan. In equity stripping situations the predatory lender is frequently aware that the borrower does not have the ability to repay the loan and simply awaits the opportunity for foreclosure.

Davenport, *supra* note 3, at 543.

46. Davenport, *supra* note 3, at 543-44 (cataloging various fraudulent practices).

47. *See PA Study, supra* note 12, at 71.

48. *Id.*

49. *Id.*

50. *See generally* Mansfield, *supra* note 33, at 559.

51. *PA Study, supra* note 12, at 1.

52. Letter from Margot Saunders, Managing Attorney, Nat'l Consumer Law Ctr., to Rep. Michael Oxley, Chairman, Fin. Servs. Comm., U.S. House of Reps. & Rep. Barney Frank, Ranking Member, Fin. Servs. Comm., U.S. House of Reps. (December 1, 2003) [hereinafter *Saunders Letter*], [http://www.nclc.org/initiatives/predatory\\_mortgage/oxley\\_letter.shtml](http://www.nclc.org/initiatives/predatory_mortgage/oxley_letter.shtml) (last visited Nov. 11, 2005).

53. *PA Study, supra* note 12, at 1.

54. *Saunders Letter, supra* note 52.



Nonetheless, Congress has been slow to address the growing number of foreclosures that plague subprime borrowers throughout this country.<sup>55</sup>

### III. STATE USURY LAWS WERE ENACTED TO PROTECT A VULNERABLE CLASS OF BORROWERS FROM UNCONSCIONABLE INTEREST RATES

#### A. *Maryland Usury Law*

Throughout early history, the taking of interest in any form was prohibited.<sup>56</sup> Western civilizations eventually ended this prohibition but placed limits on the amount of interest one could charge.<sup>57</sup> Generally, the laws of usury in this country are governed by individual state law.<sup>58</sup> In Maryland, usury is an offense that has been condemned by the courts throughout its judicial history.<sup>59</sup> The Gilbert Law Dictionary defines usury as “[t]he lending of funds at an exorbitant rate or at a rate above that permitted by law.”<sup>60</sup> The Annotated Code of Maryland defines usury as “the charging of interest by a lender in an amount which is greater than that allowed by this subtitle.”<sup>61</sup> Lenders in Maryland may not charge simple interest<sup>62</sup> “in excess of 8 percent per year on the unpaid principal balance of a loan.”<sup>63</sup> For secondary mortgage loans,<sup>64</sup> lenders may not exceed a rate of sixteen percent.<sup>65</sup>

A loan that exceeds the eight percent maximum interest rate may escape liability, despite this State’s usury limitations, based on the ex-

55. *Id.*

56. See Jonathan R. Macey, Geoffrey P. Miller & Richard Scott Carnell, *Banking Law and Regulation* 156 (3d ed. 2001) [hereinafter *Banking Law and Regulation*].

57. *Id.* at 157.

58. *Id.*

59. See, e.g., *Wetter v. Hardesty*, 16 Md. 11, 15 (1860); *Wilson v. Russell*, 13 Md. 494 (1859); *Robertson v. Am. Homestead Ass’n*, 10 Md. 397 (1857).

60. GILBERT LAW SUMMARIES, LAW DICTIONARY (1997). Despite the “exorbitant” label, in the mid-1990’s, conventional loan rates averaged 6.71% to 8.32%, while subprime rates averaged 10.54% to 14.049%. Mansfield, *supra* note 33, at 537.

61. MD. CODE ANN., COM. LAW § 12-101(k) (LexisNexis 2005).

62. Simple interest is defined as “interest charged on the principal amount loaned the borrower.” *Id.* § 12-101(i); see also *B.F. Saul Co. v. West End Park N., Inc.*, 250 Md. 707, 717, 246 A.2d 591, 598 (1968).

63. MD. CODE ANN., COM. LAW § 12-103(a) (LexisNexis 2005).

64. A secondary mortgage loan is a loan:

secured in whole or in part by a mortgage, deed of trust, security agreement, or other lien on real property located in the State, which property:

(i) Is subject to the lien of one or more prior encumbrances, except a ground rent or other leasehold interest; and

(ii) Has a dwelling on it designed principally as a residence with accommodations for not more than four families.

*Id.* § 12-401(i).

65. *Id.* § 12-404(b).

ceptions carved out in the statute.<sup>66</sup> Section 12-103(b) of the Commercial Law Article permits a lender to charge any amount of interest when the loan is a first mortgage loan on the property, and the lender is an institution that is subject to the provisions of § 501(a)(1) of the DIDMCA.<sup>67</sup>

### B. Pennsylvania Usury Law

Pennsylvania enacted the Residential Mortgage Act to offer a more flexible interest rate for mortgage loans.<sup>68</sup> The terms of the law, codified at 41 Pa. Stat. Ann. § 301, supersede the otherwise six percent state cap.<sup>69</sup> The Residential Mortgage Act sets the usury rate for mortgage loans at two and a half percent above the monthly index on long term United States Government Bonds.<sup>70</sup> Despite this more flexible cap, like Maryland, loans covered by the National Bank Act are exempt from compliance.<sup>71</sup>

### C. *The Depository Institutions Deregulation and Monetary Control Act Preempts State Usury Law.*

#### 1. The Act and its Purpose

Section 501(a) of the DIDMCA, as amended, preempts state usury rates, and provides that state laws limiting the amount of interest charged on mortgages or credit sales secured by a first lien on the borrower's property do not apply to federally related mortgage

66. *Id.* § 12-103(b)-(f).

67. *Id.* § 12-103(b). The statute provides:

(1) A lender may charge interest at *any* effective rate of simple interest on the unpaid principal balance of a loan if:

(ii) The loan is secured by a first mortgage or first deed of trust on any interest in residential real property;

(v) The loan is not a refinancing of a loan secured by a first mortgage or first deed of trust on any interest in residential real property unless:

1. The lender is a banking institution, a national banking association, a federal savings bank, a federal or State savings and loan association, or a federal or State credit union; or

2. The loan is subject to the provisions of § 501(a)(1) of the Depository Institutions Deregulation and Monetary Control Act of 1980 . . . .

*Id.* (emphasis added).

68. David L. Schwalm, Comment, *Usury in Pennsylvania: Revision of Maximum Interest Rate and Finance Charge Laws*, 84 DICK. L. REV. 241, 246 (1980).

69. Compare 41 PA. STAT. ANN. tit. 41, § 301(b) (West 1999) (setting the maximum rate of interest for residential mortgages), with *id.* § 201(b) ("Except as provided in Article III of this Act, the maximum lawful rate of interest . . . shall be six per cent per annum.").

70. Schwalm, *supra* note 68, at 246.

71. Schwalm, *supra* note 68, at 260 n.130 (states cannot apply their own usury limits to an out-of-state national bank).

loans.<sup>72</sup> Federally related mortgage loans are loans extended by institutions that are federally insured, or regulated in part, by a federal regulatory body as described in § 527(b) of the National Housing Act.<sup>73</sup> Congress enacted the DIDMCA during a period of skyrocketing mortgage interest rates—rates that in many cases exceeded state usury limits.<sup>74</sup> As a result, Congress felt that savings banks could not compete with other financial institutions, and by enacting the DIDMCA, created a “stable national financial system.”<sup>75</sup> Section 501 was enacted “to ease the severity of the mortgage credit crunches of recent years’ by removing artificial disruptions in the national mortgage lending market caused by restrictive state laws.”<sup>76</sup> Congress did, nonetheless, give states the opportunity to opt out of the preemption during a pre-

72. 12 U.S.C. § 1735f-7a(a)(1) (West 2000).

73. The DIDMCA provides:

(1) The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest . . . shall not apply to any . . . mortgage, credit sale, or advance which is—

(A) secured by a first lien on residential real property

. . . .  
(C) described in section 527(b) of the National Housing Act. *Id.* § 527(b) of the National Housing Act states:

(b) For purposes of subsection (a) of this section, the term “federally related mortgage loan” means any loan which—

(1) is secured by residential real property designed principally for the occupancy of from one to four families; and

(2)(A) is made in whole or in part by any lender the deposits or accounts of which are insured by any agency of the Federal Government, or is made in whole or in part by any lender which is itself regulated by any agency of the Federal Government; or

(B) is made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by the Secretary of Housing and Urban Development or any other officer or agency of the Federal Government or under or in connection with a housing or urban development program administered by the Secretary of Housing and Urban Development or a housing or related program administered by any other such officer or agency; or

(C) is eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or from any financial institution from which it could be purchased by the Federal Home Loan Mortgage Corporation; or

(D) is made in whole or in part by any “creditor,” as defined in *section 1602(f) of Title 15*, who makes or invests in residential real estate loans aggregating more than \$1,000,000 per year.

12 U.S.C. § 1735f-5(b).

74. Basis Points, *Section 501 Preempts California Restriction on When Interest Can Accrue*, <http://www.docmagic.com/compliance/basispoints/05-03.pdf> (last visited Nov. 11, 2005).

75. *Id.*

76. 73 Md. Op. Att’y Gen. 144, 151 (1988) (quoting S. REP. NO. 96-368, at 18 (1979), as reprinted in 1980 U.S.C.C.A.N. 236, 254).

scribed window of time.<sup>77</sup> Colorado, Hawaii, Idaho, Iowa, Kansas, Maine, Minnesota, Nebraska, Nevada, North Carolina, Puerto Rico, South Carolina, South Dakota, and Wisconsin were the only states to do so.<sup>78</sup>

## 2. The Growth of Subprime Lending Following the DIDMCA

Subprime mortgage lending grew substantially following the enactment of the DIDMCA.<sup>79</sup> In 2000, \$140 billion was generated by the origination of subprime loans, compared to only \$35 billion in 1994,<sup>80</sup> and \$7 billion in 1990.<sup>81</sup> Subprime mortgages for single-family residential mortgage debt were reported at \$370 billion in 1999.<sup>82</sup> Seventy-six percent of subprime lending in 1999 was based on home equity lending, however, about three-fourths of all subprime loans originated in the same year held the first lien position.<sup>83</sup> As noted above, many subprime borrowers utilize equity in their homes to secure a mortgage, preferably a second mortgage, through home equity loans in order to pay off other debt or make home repairs.<sup>84</sup> These individuals would not qualify for second mortgage loans from lending institutions that are obligated to stay within the state usury caps on non-first lien mortgages.<sup>85</sup> Consequently, unscrupulous lenders have used this preemption to wrap second mortgage debt into a new first mortgage lien.<sup>86</sup> In doing so, instead of extending a small second mortgage, i.e., in the form of a home improvement loan, the lender refinances the entire first and second mortgage debt into one "first" lien package.<sup>87</sup> By doing so, qualifying lenders preempt state law.<sup>88</sup> This scenario is illustrative of many in which a conventional lender would not be able to offer a second mortgage loan to a subprime bor-

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77. Donna S. Harkness, *Predatory Lending Prevention Project: Prescribing a Cure for the Home Equity Loss Ailing the Elderly*, 10 B.U. PUB. INT. L.J. 1, 27 (2000).

78. *Id.* at 27 n.166.

79. Laderman, *supra* note 19, at 1-2. The Tax Reform Act of 1986 also led to the growth of subprime mortgage lending. *Id.* The Act permitted consumers to deduct interest paid on loans secured by their homes and ended the deductions on consumer interest. *Id.*

80. *Id.*

81. Mansfield, *supra* note 33, at 528.

82. Silverman, *supra* note 30, at 493-94.

83. Laderman, *supra* note 19, at 1.

84. *See supra* Part I.C.

85. *See infra* Part IV.C.

86. Mike Hudson, *Stealing Home: How the Government and Big Banks Help Second Mortgage Companies Prey on the Poor*, 26 CLEARINGHOUSE REV. 1476, 1480 (1993).

87. *Id.*

88. 12 U.S.C. § 1735f-7a(a)(1) (West 2000) (stating that state laws that limit interest rates or other charges shall not apply to any loan or mortgage secured by a first lien). *But see* Sweeney v. Sav. First Mortgage, LLC, 388 Md. 319, 338, 879 A.2d 1037, 1048 (2005) (mortgage brokers are not "qualifying lenders" able to preempt Maryland law).

rower within the limits of a given usury ceiling, yet, the subprime lender circumvents the law by creating a new first lien on the property.<sup>89</sup>

### 3. Home Equity Lending<sup>90</sup>

As a result of the DIDMCA, the only regulation on loan interest rates for first lien mortgages is the market itself.<sup>91</sup> Debt consolidation, home improvement loans, and other forms of home equity loans can have unlimited rates of interest as long as the loan takes the form of a first lien position on the borrower's residential property.<sup>92</sup> The popularity of home equity lending has grown substantially in recent years. In 1983, 6.8% of homeowners had home equity debt, which grew to 11% in 1988, and 15% in 1989.<sup>93</sup> In 1999, home equity lending accounted for seventy-six percent of loans originated by subprime lenders.<sup>94</sup> These numbers do not include refinancing debt; many homeowners paid off existing mortgages and other debt, utilizing the equity in their homes and often at rates exceeding that of the prior first mortgage.<sup>95</sup> Also, it is worth noting that sixty-eight percent of home equity loans were used to pay off other consumer debt in 1993 and 1994, a sharp rise from thirty-five percent in 1988.<sup>96</sup> Additionally, because these loans were made by subprime lenders securing a first lien position on the borrower's property, the borrower's monthly payments also rose sharply.<sup>97</sup>

#### *a. Increased Foreclosure Rates for Subprime Loans*<sup>98</sup>

The effects of the growth of subprime home equity lending in the mid-nineties has since come to fruition in recent years.<sup>99</sup> Specifically, the consequences of default when a home equity loan secures a first

89. See 12 U.S.C. § 1735f-7a(a)(1).

90. Prior to the growth in popularity of the DIDMCA, home equity loans "which were being made mostly to prime borrowers, were still cast mostly as second mortgages and tended to have lower balances, shorter maturities, and low combined loan to value ratios . . . ." Mansfield, *supra* note 33, at 523.

91. *Id.* at 542-43.

92. *Id.*

93. *Id.* at 522-23.

94. Laderman, *supra* note 19 (About seventy-five percent of loans originated by subprime lenders in 1999 were first lien loans). See *supra* note 79 and accompanying text.

95. Laderman, *supra* note 19.

96. Mansfield, *supra* note 33, at 524.

97. See Temkin et al., *supra* note 8 (quoting U.S. DEP'T OF HOUS. AND URBAN DEV. & U.S. DEP'T OF TREASURY, CURBING PREDATORY LENDING REPORT 31 (2000)), available at <http://www.huduser.org/publications/pdf/treasrpt.pdf>.

98. See *supra* Part II for a discussion of predatory practices that lead to foreclosure.

99. Mansfield, *supra* note 33, at 554.

lien position on a homeowner's property are devastating.<sup>100</sup> As discussed in Part I, many of the loans are made based on the equity in the borrower's home without regard to the borrower's ability to repay the loan.<sup>101</sup> When a homeowner borrows against the equity in the home, the loan-to-value ratio rises.<sup>102</sup> A higher loan-to-value ratio is often indicative of increased likelihood of foreclosure.<sup>103</sup> In some cases, borrowers borrowing against home equity cannot even afford to pay the first monthly payment.<sup>104</sup>

Default and foreclosure have become increasingly common in the market of subprime lending.<sup>105</sup> A first lien position on the borrower's home makes the stakes of default much higher.<sup>106</sup> Unlike subordinate lienholders, the foreclosing first mortgagee has few obstacles preventing foreclosure.<sup>107</sup> The loss of one's home under such circumstances is tragic.<sup>108</sup> Among other things, foreclosure can lead to the loss of shelter, homelessness, family break-up, overcrowded living conditions with relatives willing to provide shelter, and the absence from school by children relocated after losing their home.<sup>109</sup> In many cases, the borrower would never be in such a position had it not been for her dealings with the subprime lender.<sup>110</sup> In addition to the fact that individual borrowers and families are now homeless and have irreparable credit; on a larger scale, neighborhood deterioration also results.<sup>111</sup> It is inconceivable to think that putting victims of predatory transactions out of their homes does not offend the most fundamental sensibilities common to communities across the country. "Oddly enough, this is the same concern that led Congress into the home mortgage market during the Great Depression, and the opposite result of what Congress intended when it passed DIDMCA."<sup>112</sup>

Mortgage fraud and predatory real estate practices lead to vacant housing and deteriorating neighborhoods in all metropolitan neigh-

100. *Id.* at 555.

101. *See supra* Part I.A-B.

102. Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 382 n.38 (1994) (citing JOHN P. HERZOG & JAMES S. EARLY, HOME MORTGAGE DELINQUENCY AND FORECLOSURE xvii-xix (Nat'l Bureau of Econ. Research 1970)).

103. *Id.* (citing JOHN P. HERZOG & JAMES S. EARLY, HOME MORTGAGE DELINQUENCY AND FORECLOSURE, xvii-xix (Nat'l Bureau of Econ. Research 1970)).

104. Mansfield, *supra* note 33, at 553 ("[O]n some loan portfolios, 'first payment delinquencies' may run as high as 25 percent."). *Id.* at 553, n.480.

105. *Id.* at 553-54.

106. Forrester, *supra* note 102, at 385-86.

107. *Id.* at 381, n.387 (citing JOHN P. HERZOG & JAMES S. EARLY, *supra* note 102, at xvii-xix).

108. Forrester, *supra* note 102, at 385.

109. *See Id.* at 386.

110. Mansfield, *supra* note 33, at 554.

111. *Id.* at 555.

112. *Id.*

borhoods.<sup>113</sup> In Baltimore, subprime lenders originated twenty-one percent of all mortgage loans, yet were responsible for forty-five percent of the city's foreclosures.<sup>114</sup> Regardless of neighborhood, boarded up and dilapidated homes detrimentally affect the economic viability of any community.<sup>115</sup>

*b. Disparate Impact on Minorities*

Studies indicate that subprime lenders target minority groups.<sup>116</sup> The Woodstock Institute published a study showing that "in predominantly African-American neighborhoods, subprime lenders account for 58 percent of conventional [sic] refinance loans, as compared to less than 10 percent in predominantly white tracts."<sup>117</sup> Additionally, in white neighborhoods in 1998, seventeen of twenty lenders for conventional refinancing loans were prime lenders; while eighteen of twenty lenders in African American neighborhoods, based on loan applications, were subprime lenders.<sup>118</sup>

#### IV. BREAKING THE CEILING<sup>119</sup>

At a time in which foreclosure rates are rising, neighborhoods are in decay, and conventional lending institutions seem to be extinct in

113. *See id.*

114. Twohig, *supra* note 2.

115. *See Silverman, supra* note 30, at 530.

116. *See Mansfield, supra* note 33, at 560.

117. *Id.* (citing Daniel Immergluck & Marti Wiles, TWO STEPS BACK: THE DUAL MORTGAGE MARKET, PREDATORY LENDING, AND THE UNDOING OF COMMUNITY DEVELOPMENT, 1999 WOODSTOCK INST. 19).

118. Mansfield, *supra* note 33, at 560, n.532 (citing Immergluck & Wiles, *supra* note 117, at 30).

119. It is important to note that Congress enacted the Home Ownership and Equity Protection Act (HOEPA) in 1994, in response to predatory lending abuses. Pub. L. No. 103-325, 108 Stat. 2190 (codified as amended in scattered sections of 15 U.S.C.). *See also* Davenport, *supra* note 3, at 548 ("In specific response to growing problems of predatory lending and concerns about TILA's shortcomings as a device to combat practice, Congress amended TILA in 1994 by enacting HOEPA."). HOEPA requires specific disclosures, including annual percentage rates, monthly payments, and loan fees for "high cost closed-end loans secured by the borrower's home . . . ." *Id.* at 548-49. *See* HOEPA, Pub. L. No. 103-325, 108 Stat. 2190 (codified as amended in various sections of 15 U.S.C.). Furthermore, HOEPA targets predatory lending by barring common predatory loan terms, such as balloon payments, prepayment penalties, increased rates at the time of default, while mandating additional disclosures to the borrower. *Id.* Critics claim that HOEPA is only a first step at combating predatory lending, and that it does not go far enough. Mansfield, *supra* note 33, at 564-65. In addition, HOEPA only applies to high-cost closed-end loans and not purchase money loans and open-end credit. *See* Davenport, *supra* note 3, at 549-50. Additionally, the threshold, some have argued, is too high—many predatory lenders can continue business as usual, but keep the loan terms just below HOEPA trigger points. *Id.* at 559. Remedies available under Pennsylvania's Consumer Equity Protection Act, or Act 55, are less advanta-

low-income and minority areas,<sup>120</sup> clearly, the unintended consequences that have resulted from DIDMCA must be addressed.<sup>121</sup> Unfortunately, Congress has failed to take action to remedy the consequences of this legislation.<sup>122</sup>

#### A. Reaction by Certain States

Immediately following the enactment of the DIDMCA, several states had the foresight to affirmatively “opt out” of the statute.<sup>123</sup> Since that time, certain states have taken additional preventative steps to protect vulnerable borrowers.<sup>124</sup> For example, Massachusetts opted out of DIDMCA when the Massachusetts Division of Banks “promulgated . . . [the] High Cost Mortgage Loan Regulations,” effective in 2001.<sup>125</sup> The Massachusetts regulations require certain disclosures and prohibits loan flipping or asset-based lending.<sup>126</sup> In addition to enacting remedial legislation,<sup>127</sup> North Carolina extended its “opt out” provision, protecting borrowers in Pennsylvania.<sup>128</sup> In *Flannick v. First Union Home Equity Bank*, a North Carolina Bank extended a loan at a rate exceeding North Carolina’s usury limits to Pennsylvania residents who had visited First Union’s processing office in Penn-

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geous to borrowers than those available under HOEPA. *PA Study*, *supra* note 12, at 78. *See also* § 153, 108 Stat. at 2195-96 (HOEPA enacted an entire section addressing damages for violating this provision). On the other hand, some argue that a lower HOEPA threshold would lead to more expensive loans for borrowers. *See PA Study*, *supra* note 12, at 78.

120. *See supra* notes 114-15 and accompanying text.

121. *See supra* notes 79-88 and accompanying text.

122. *See Mansfield*, *supra* note 33, at 574.

123. KATHELEEN E. KEEST & ELIZABETH RENUART, *The Cost of Credit Regulation and Legal Challenges*, 104 (Nat’l Consumer Law Ctr. 2d ed. 2000).

124. *Id.* at 104, n.354.

125. Stephen F. Ornstein, MASSACHUSETTS ENACTS HIGH COST MORTGAGE REGULATIONS, 118 BANKING L.J. 427, 427 (2001). “The significance of the new Massachusetts law is that it substantially augments Massachusetts’ existing provisions addressing ‘high cost mortgages’ and renders assignees of Massachusetts high cost loans subject to the same penalties that could be asserted against the originator.” *Id.* at 428. So, “[i]n other words, the existing 209 CMR [§] 32.32, which was the Massachusetts version of the federal [sic] provisions implementing HOEPA[,] has been replaced, effective March 22, 2001, by the new provisions of the High Cost Mortgage Regulations.” *Id.* at n.1; *see* 209 MASS. CODE REGS. 32.32 (1987) (version of the Massachusetts Code of Regulations that was replaced).

126. Ornstein, *supra* note 125, at 433. *See also* Mansfield, *supra* note 33, at 553 (“These regulations require disclosures to the borrower . . . and strictly prohibit balloon payments, negative amortization, advance payments, and asset-based lending . . . and prohibit loan flipping. . .”).

127. N.C. GEN. STAT. § 24 (2003).

128. *See Flannick v. First Union Home Equity Bank*, 134 F. Supp. 2d 389 (E.D. Pa. 2001); N.C. GEN. STAT. § 24-2.33.



sylvania.<sup>129</sup> The court struck down the loan in violation of North Carolina law.<sup>130</sup>

The aforementioned examples of state initiatives to neutralize the effects of DIDMCA are positive remedial steps. The problem remains, however, for those states that did not initially "override" the DIDMCA legislation.<sup>131</sup> Practitioners in the field have developed several theories on the best course of action, other than repealing DIDMCA, to remedy its inherent problems.<sup>132</sup>

### B. Recommendations by Practitioners

Consumer advocates have called for a change.<sup>133</sup> Recommendations set forth in one study included increased lending for borrowers traditionally labeled as "subprime borrowers" by conventional lenders, stronger state and federal regulation to "protect consumers," and stricter prosecution and penalties for predatory lending.<sup>134</sup> Clearly, the subprime borrower is in need of broader protection.<sup>135</sup> One possible remedy is a federal usury limit on subprime home equity lending, or a general federal usury limit for mortgage lending in order to both protect unsophisticated borrowers and "prevent[ ] overcompensation to lenders," while simultaneously setting a "societal cap" on the value of lending money.<sup>136</sup> Such arguments rest on the basis that usury limits protect borrowers who are unable "to understand complex financial transactions," in addition to protecting "loan source funds."<sup>137</sup> Additional protection could come by way of a "floating maximum [interest] rate" set by Congress.<sup>138</sup> This type of rate regulation must come at the federal level, in order to prevent lenders from "maneuver[ing] around [non-uniform] state regulations."<sup>139</sup>

129. 134 F. Supp. 2d 389, 392, 394, 397-98; see N.C. GEN. STAT. § 24-1.1(b).

130. *Flannick*, 134 F. Supp. 2d at 399; see also N.C. GEN. STAT. § 24-1.1(b) ("Nothing in this section shall be construed to authorize the charging of interest on committed funds prior to the disbursement of said funds.").

131. *Flannick*, 134 F. Supp. 2d at 389, 392, 394, 397-98. See N.C. GEN. STAT. § 24-1.1(b). Neither Maryland nor Pennsylvania opted out of DIDMCA. See MD. CODE ANN., COM. LAW § 12-103(b)(1)(v)(2) (LexisNexis 2005); 41 PA. STAT. ANN. § 604 (West 1999); see also 73 Md. Op. Att'y Gen. at 147 ("[I]t is clear that Maryland has not overridden the federal preemption.").

132. See Common Dreams, *Minority and Low Income Homeowners More Likely to Receive High Interest Mortgages*; ACORN Study Documents Problem of Predatory Lending & "Financial Apartheid" (Nov. 1, 2000), <http://www.commondreams.org/news2000/1101-01.htm> [hereinafter *Common Dreams*].

133. *Id.*

134. *Id.*

135. See Mansfield, *supra* note 33, at 573-74.

136. *Id.* at 573.

137. *Id.*

138. *Id.* at 574.

139. *Id.*

Alternatively, increased protection would result from the elimination of federal preemption for all nonpurchase money loans.<sup>140</sup> Through this approach, home equity lending and refinance loans would comply with state usury limits.<sup>141</sup> Overall, consumer advocates agree that there must be some type of rate regulation protecting home equity borrowers in order to alleviate subprime lending abuse.<sup>142</sup>

C. *This Author's Recommendations: Abolish State Usury Limits<sup>143</sup> and Enforce Existing Remedies<sup>144</sup>*

Skyrocketing foreclosure rates and the growth of predatory lending practices makes clear the need to protect vulnerable home equity borrowers who fall prey to complacent subprime lenders.<sup>145</sup> As discussed in Parts I and III, typical subprime borrowers cannot get a home equity loan from a conventional lender; the amount is too little and the risk is too high for the bank to be in compliance with state usury regulations.<sup>146</sup> That same borrower, left to obtain a loan from a subprime lender, does not get the second mortgage loan needed; rather, the borrower must take on a costly new first mortgage loan.<sup>147</sup> The subprime lender eludes state usury caps and obtains a first lien position on the borrower's home.<sup>148</sup> The borrower is unable to pay, defaults on the loan, and is left without a home and with irreparable credit.<sup>149</sup> Accordingly, what is necessary is the complete abolishment of existing state usury limits for loans secured by real property. At the same time, federal agencies must take affirmative steps to enforce the Community Reinvestment Act thereby ensuring that banks are located in the neighborhoods that desperately need their services.<sup>150</sup>

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140. Forrester, *supra* note 102, at 447-48.

141. Mansfield, *supra* note 33, at 574. *But see* Sweeney v. Sav. First Mortgage, LLC, 388 Md. 319, 338, 879 A.2d 1037, 1048 (2005) (finding that a mortgage proposal failed to consider federal jurisdiction over "qualified lender[s]").

142. *See* Mansfield, *supra* note 33, at 574.

143. I am only suggesting the elimination of usury limits as they relate to mortgage lending, not in other areas of consumer law.

144. *See* Community Reinvestment Act of 1977, §§ 2901-06 (2001). Other remedies, such as HOEPA, do exist. *See supra* note 119. But for the purposes of this paper, I am focusing on the Community Reinvestment Act.

145. *See supra* notes 33-37 and accompanying text.

146. *See supra* Parts I and III.

147. *See supra* notes 84-86 and accompanying text.

148. *See supra* notes 85-86 and accompanying text.

149. *See supra* notes 106-11 and accompanying text.

150. *See* 12 U.S.C. § 2901 (West 2000).

It looks like we still have two separate and very unequal financial systems. One for the rich and one for the poor. One for whites, and one for everyone else. The banks created this situation when they abandoned our neighborhoods and opened the door for the loan sharks. Now we're finding that these same banks are profiting from us through their financing or even ownership of

## 1. The Community Reinvestment Act

The Community Reinvestment Act (hereinafter "CRA" or "the Act") was enacted to guarantee credit opportunities to members of low- and moderate-income communities.<sup>151</sup> Since its inception in 1977, the Act has sought to ensure access to credit in communities across the nation.<sup>152</sup> The CRA specifically prohibits geographical discriminatory lending practices and guarantees that access to credit is made available for persons of low- and moderate-income within the areas in which the banks operate.<sup>153</sup> Traditionally, the banking industry has limited credit access to those members of society with the highest incomes.<sup>154</sup> In the face of such elitism, the CRA was enacted to equalize the disparaging credit opportunities for those in low- to middle-income communities.<sup>155</sup> The goals of the Act are evident in the text of the statute itself.<sup>156</sup> "The CRA requires 'appropriate Federal financial supervisory agenc[ies],' in connection with their examination of financial institutions, to 'assess the institutions' record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods. . . ."<sup>157</sup>

Regulators, including the Office of the Comptroller of the Currency, assign a rating to each banking institution based on that bank's record of meeting the credit needs of the low- and moderate-income members of its community.<sup>158</sup> The rating is considered by such regulators when a bank applies for a new charter, deposit insurance, a new branch, or a merger or acquisition.<sup>159</sup> Institutions are required to keep CRA information on file and to make it available for the public.<sup>160</sup>

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these predatory lenders . . . [w]e know that many of the people who got subprime loans could have qualified for a lower cost mortgage, but instead they were pushed into a higher cost loan because the mortgage company saw an opportunity to make more money.

*Common Dreams*, *supra* note 132.

151. *Banking Law and Regulation*, *supra* note 56, at 186.

152. *Id.* See also 12 U.S.C. § 2901(b) (stating the purpose of the Act is to "help meet the credit needs of the local communities").

153. See Marcia Johnson, JaPaula Kemp & Anh Nguyen, *The Community Reinvestment Act: Expanding Access*, 12 KAN. J.L. & PUB. POL'Y 89, 89 (Fall 2002).

154. *Id.* at 89-90.

155. See *id.* at 89; *Banking Law and Regulation*, *supra* note 56, at 186. See also 12 U.S.C. § 2901(b) (stating that the purpose of the statute is "to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions").

156. See 12 U.S.C. §§ 2901, 2903, 2906.

157. *Banking Law and Regulation*, *supra* note 56, at 186 (quoting 12 U.S.C. § 2903).

158. *Id.* at 187. See 12 U.S.C. § 2903(a)(1).

159. *Banking Law and Regulation*, *supra* note 56, at 186-87. See § 2903(a)(2).

160. *Banking Law and Regulation*, *supra* note 56, at 191.

Initially, the CRA was an effective tool for regulatory enforcement.<sup>161</sup> Since its inception, however, it has generated a great deal of criticism as disadvantaging banking institutions, and was thus controversial to members of Congress.<sup>162</sup> Additionally, the emergence of Internet banking will make it difficult for regulators to define a given institution's "community" in order to assign a CRA rating.<sup>163</sup> In light of the fact that "[f]inancial institutions that offer their services via the Internet are not currently regulated by the CRA," the Act has gone largely unenforced in recent years.<sup>164</sup>

Discriminatory practices in lending, rising foreclosure rates, and a growing subprime industry make enforcement of the CRA more needed than ever before.<sup>165</sup> If Congress focused on enforcing this legislation and requiring, for example, that financial institutions located in northeast Baltimore City serve the entire community, including low-income residents therein, the CRA would finally serve as an effective tool for alleviating the problems that it was enacted to address.<sup>166</sup>

## 2. The J.P. Morgan Chase Example

In January of 2004, one of the leading subprime lending institutions, J.P. Morgan Chase ("Chase"), took affirmative steps to acquire Bank One.<sup>167</sup> Prior to these steps, there were a number of complaints filed against Chase with various state regulators.<sup>168</sup> Neither Chase, nor Bank One, has a clean record when it comes to dealing with subprime borrowers.<sup>169</sup> For example, in 2002, Bank One disclosed its ties to "First American Cash Advance," a payday lender in inner city Chi-

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161. *Id.*

162. *Id.* at 191, 193-94 (citing Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 294-96 (1993)).

163. Johnson et al., *supra* note 153, at 101-02.

164. *Id.* at 102-03 (stating that while institutions "that offer their services via the Internet are not currently regulated by the CRA . . . developments in on-line banking . . . call for a reevaluation of the CRA").

165. See discussion *supra* Parts I & II.

166. But see Forrester, *supra* note 102, for a discussion of banks purchasing notes from predatory lenders lending in low-income areas to satisfy the Bank's CRA obligation.

167. Inner City Press & Fair Finance Watch, *The J.P. Morgan Chase Watch*, March 8, 2004, [www.innercitypress.org/jpmchase.html](http://www.innercitypress.org/jpmchase.html).

168. *Id.*

169. *Id.*

cago.<sup>170</sup> Additionally, Chase has acted as trustee on subprime loans in foreclosure for loans serviced by Fairbanks Capital.<sup>171</sup>

Bank One, member FDIC, has a number of branches with varying CRA rates.<sup>172</sup> Chase, evaluated by the Federal Reserve Bank of New York, received its seventh “Outstanding” rating in a row.<sup>173</sup> Clearly there is some disconnect in this rating. In the Bronx alone, Chase closed branch after branch in low-income neighborhoods or in neighborhoods just a few blocks from low-income neighborhoods.<sup>174</sup> The branch on Tremont Avenue closed its doors leaving no Chase branch for “twenty or more blocks in any direction.”<sup>175</sup> Consequently, only “one-fifth of the bank’s mortgage applications in the Bronx [come] from South Bronx,” a poor and economically disparaged community in the area.<sup>176</sup> Furthermore, during 2002 in the Boston area, “Chase Manhattan Mortgage Corporation denied loan applications from African Americans 8.89 times more” often than from whites, while Latinos were denied 6.38 times more often.<sup>177</sup> These figures are up from 1999, when African Americans were denied loans only 2.34 times more often than those of white applicants.<sup>178</sup> Additionally, Chase has ties to subprime lenders with unscrupulous reputations, in addition to Fairbanks, including Centex, Household/Decision One, First Franklin, and NovaStar, which recently received a “cease-and-desist order for ‘unauthorized mortgage broker activity.’”<sup>179</sup> First Franklin’s market share in Pennsylvania increased from \$4,825.3 million in 2003 to \$14,042.6 million in 2004.<sup>180</sup> Novastar increased from \$86.5 million to \$5,664.1 million during the same time period.<sup>181</sup>

The Chase—Bank One acquisition serves as a clear example of the need for reform. In particular, the acquisition illustrates the strategies undergone by lenders to avoid the state usury and other lending regu-

170. *Id.* Applicants receiving a “payday” loan sign a pledge during the transaction, which, in small print, states that the applicant “fully release[s] all parties, companies, their subsidiaries and employees, past or present, from any and all liability for any damage that may result. My signature below indicates that for purposes of verification and qualification, I have voluntarily waived the protection of all rights to privacy laws.” *Id.*

171. *Id.*

172. See FFIEC Interagency CRA Ratings Search, <http://ffiec.gov/cracf/crarating/main.cfm>.

173. JP Morgan Chase Bank Receives “Outstanding” CRA Rating, Feb.5, 2004, <http://www.jpmorganchase.com/cm/cs?pagename=chase/Href&urlname=jpmc/community/cdg/cra>.

174. Inner City Press & Finance Watch, *supra* note 167.

175. *Id.*

176. *Id.* (citing Saul Hansell, *Bronx Group Is Challenging A Planned Merger by Chase*, N.Y. TIMES, Nov. 5, 1994, § 1).

177. Inner City Press & Finance Watch, *supra* note 167.

178. *Id.*

179. *Id.*

180. *PA Study*, *supra* note 12, at 71.

181. *Id.*

lations, utilizing the provisions of DIDMCA.<sup>182</sup> Such strategies demonstrate how ineffective state usury limits are,<sup>183</sup> as well as the need to enforce already existing legislation, primarily the CRA, in combating abusive practices by national lenders.<sup>184</sup> In this example it is clear that the existing state usury laws are neutralized by a merger of Chase and Bank One.<sup>185</sup> In this example it is also apparent that the CRA is the most effective tool in stopping these abusive practices.<sup>186</sup> In other words, a complete CRA investigation, prior to granting approval for the acquisition, would set forth a series of examples of Chase's failure to meet the needs of its community at large.<sup>187</sup> An investigation such as this, however, would require looking beyond the ledgers located in Chase's Manhattan office and into the communities allegedly served.<sup>188</sup> The report would reflect the disparities and illustrate the flight from urban settings and surging denial rates among minorities.<sup>189</sup> Therefore, the acquisition would be barred until remedial measures are taken. Such consequences are at the heart of the CRA, and in furtherance of its legislative purpose.<sup>190</sup>

### 3. Reaction to My Recommendation

The recommendation to abolish usury, set forth above, would be more effective than existing consumer remedies have proven to be.<sup>191</sup> Under my proposal, enforcement would come from federal regulators' assessments of an institution's record of meeting the credit needs of low-income members of its community prior to approving an application for expansion.<sup>192</sup> Rather than leaving unsophisticated and indigent consumers with the burden of detecting a violation and bringing an action against the lender, the bank itself would be regulated.<sup>193</sup>

182. See, e.g., Diane Hellug, *Exposing the Loansharks in Sheep's Clothing: Why Re-Regulating the Consumer Credit Market Makes Economic Sense*, 80 NOTRE DAME L. REV. 1567, 1605, 1608 (2005). When a federally insured depository is acquired by a state institution, that state institution is covered by the National Bank Act and enjoys federal preemption under the DIDMCA. See *id.*

183. See *id.* at 1608-09.

184. See Kathleen C. Engel & Patricia A. McCoy, *The CRA Implications of Predatory Lending*, 29 FORDHAM URB. L.J. 1571, 1592-93 (2002).

185. See *id.* at 1608.

186. *Id.* at 1592-94.

187. See *supra* notes 155-57 and accompanying text.

188. *But see supra* notes 162-64 and accompanying text.

189. See *supra* notes 174-81 and accompanying text.

190. See *supra* notes 151-57 and accompanying text.

191. Compare discussion *supra* Part IV.C with discussion *supra* Part IV.B. *But see* Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 PEPP. L. REV. 151, 171 (1998) (discussing the benefits of usury laws for consumers).

192. See 12 U.S.C. §§ 2901, 2903(a) (2000); discussion *supra* Part IV.A.

193. See 12 U.S.C. § 2903(a).

Congress has been indefatigable in creating new rights and causes of action for consumers in connection with the provision of credit . . . . While usury rules are designed to police the substantive fair-

Furthermore, proper enforcement of the CRA would bring banks back to the neighborhoods most often targeted by subprime lenders.<sup>194</sup> To date, banks have vanished from low-income neighborhoods at alarming rates, only to be replaced by subprime institutions.<sup>195</sup> Enforcement of the CRA would ensure that, prior to a bank gaining approval for expansion, its record of meeting the credit needs of low- to moderate-income borrowers would be assessed via a CRA rating.<sup>196</sup> Approval for expansion would not be granted without a satisfactory CRA rating.<sup>197</sup> Therefore, banks wishing to expand would first have to serve the credit needs of the borrowers most in need of accessing credit.<sup>198</sup> As a result, banks which had previously vacated branches in the inner city, but maintained an ATM in the same neighborhood and had a payday lender subsidiary, or have opened a branch in a wealthier bordering neighborhood, would have to reopen vacant branches to generate credit opportunities sufficient to achieve a satisfactory CRA rating.<sup>199</sup> Greater banking presence will lead to greater access to conventional loans for current subprime borrowers.<sup>200</sup> Currently, it is suggested that thirty-five percent of subprime borrowers qualify for conventional loans, but are unaware of it.<sup>201</sup> Accordingly, proper enforcement of the CRA will require banks to truly serve the communities in which they exist, including all neighborhoods in those communities.<sup>202</sup> In urban areas, where wealthy neighborhoods border low-income neighborhoods, conventional lenders already lending to the wealthy homeowners will have to lend to all members of the same extended community.<sup>203</sup>

There are some obvious areas of concern in the aforementioned theory. First, if the CRA has been ineffective in certain circumstances, as evidenced by the Chase-Bank One example,<sup>204</sup> why should it now

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ness of the bargain under which credit is supplied, the newer rules tend to regulate the procedures for the supply of credit, especially the disclosures required for banks and other lenders.

*Banking Law and Regulation*, *supra* note 56, at 172.

194. See *supra* note 166.

195. See Consumer's Union, *Rich House, Poor House: The Two Faces of Home Equity Lending*, Executive Summary, March 1997, <http://www.consumersunion.org/finance/home-tx1.htm> and <http://www.consumersunion.org/finance/home-tx2.htm>.

196. See *supra* note 158 and accompanying text.

197. See 12 U.S.C. §§ 1843(1)(2), 2903, 2906(b)(2).

198. See *Banking Law and Regulation*, *supra* note 56, at 187.

199. See *id.* at 187, 190-91.

200. See *supra* Part I.B.

201. Mansfield, *supra* note 33, at 559 (citing Karen Hube, *In the Wild West of Subprime Lending, Borrowers Have to Dodge Many Bullets*, WALL ST. J., March 18, 1998, at C1).

202. See *Banking Law and Regulation*, *supra* note 56, at 190-91.

203. See generally *id.* (asserting that under the CRA, an "assessment area" within a "community" must consist of "whole geographics . . . [and] may not arbitrarily exclude low- or moderate-income areas . . .").

204. See discussion *supra* Part IV.C.2.

serve as an effective remedy? Second, the proposed recommendation ignores non-federally chartered lending institutions outside of the CRA's jurisdiction.<sup>205</sup> Nevertheless, the need to enforce the CRA is a *preexisting concern* that Congress must address in light of changing banking practices.<sup>206</sup> For example, the emergence of Internet banking discussed *supra*, in Part IV.C.1. Congress must understand the need for credit opportunities in light of predatory lending practices in the inner city, and reaffirm its commitment to enforcing the guiding principles of the CRA.<sup>207</sup> This must occur in order for such a proposal to take effect. Furthermore, abolishing usury limits in order to increase credit opportunities for borrowers with damaged credit is consistent with the view taken by a number of economists.<sup>208</sup> For a number of years, economists have argued that usury limits reduce credit opportunities for those in need, particularly those with low incomes or poor credit.<sup>209</sup> Individuals without access to credit because of such limits imposed on banks are therefore left to rely on "predatory lenders."<sup>210</sup> The opinion set forth by economists is consistent with the underlying intent of the CRA.<sup>211</sup> Abolishing usury and enforcing the CRA will bring banks back to low-income neighborhoods, making it unnecessary for residents to turn to subprime institutions to access credit.<sup>212</sup>

Ideally, the presence of conventional lenders would drive away subprime lenders targeting borrowers in the same neighborhood.<sup>213</sup> Residents would be able to receive home equity loans at rates that accurately reflect the risk undertaken by the bank.<sup>214</sup> The borrower is protected on two levels. First, multiple federal authorities would regulate the bank,<sup>215</sup> thereby regulating underwriting standards, monthly

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205. See generally 12 U.S.C. §§ 2902(3), 2903(a) (applying CRA regulations only upon institution's application for federal charter); *supra* Part IV.C.1 (promoting enforcement of the CRA).

206. See discussion *supra* Part IV.C.1.

207. See *supra* note 157 and accompanying text. But see *supra* Part IV.B for a discussion of federal regulation for proposed recommendations set forth by other consumer advocates.

208. *Banking Law and Regulation*, *supra* note 56, at 158 cmt. 7.

209. *Id.*

210. *Id.* See also Forrester, *supra* note 102, at 446-48 (discussing economist theory regarding usury).

211. See *supra* note 152 and accompanying text.

212. *Id.* See also *supra* note 13 (discussing the exodus of banks from urban areas).

213. See generally *supra* Part I.A (discussing low-income borrowers accepting subprime lenders' loans because they have no other option in their neighborhoods).

214. Compare *supra* Part I.B (discussing conventional lenders' current inability to lend within the usury cap to high-risk borrowers) with Part II (discussing excessive rate-changing practices of subprime lenders).

215. 12 U.S.C. § 2902 (West 2000) (listing authorities).



payments, and use of prepayment or balloon payments.<sup>216</sup> Second, the borrower needing a second mortgage loan of any size could get just that: a second mortgage loan.<sup>217</sup> Rather than refinancing the second mortgage into a first mortgage loan, the borrower could obtain an affordable second mortgage that holds a second lien position on the borrower's home.<sup>218</sup>

## V. CONCLUSION

The theory proposed above purports to return banks to neighborhoods that desperately need the stability and credit opportunities that the bank's return would bring. Abolishing usury alone would not end predatory subprime lending practices.<sup>219</sup> Yet, ending usury in combination with enforcing the Community Reinvestment Act, however, would offer low-income borrowers the opportunity to make meaningful choices.<sup>220</sup> Such enforcement would also offer conventional lenders the opportunity to lend and set rates that accurately reflect risk.<sup>221</sup>

It is unclear whether curbing such abuses must come from a federal usury level,<sup>222</sup> stricter guidelines for the Home Ownership and Equity Protection Act,<sup>223</sup> or through enforcement of the CRA.<sup>224</sup> What remains clear, however, is that the subprime market was the only industry that gained from Congress's enactment of the DIDMCA.<sup>225</sup> Enforcing the CRA would therefore allow low-income borrowers and banks to profit from DIDMCA.<sup>226</sup>

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216. See *Banking Law and Regulation*, *supra* note 56, at 179 (agencies will closely scrutinize loans for predatory practices).

217. *Contra supra* Part C.II (discussing subprime lenders' practice of extending new first-mortgage liens instead of second mortgages).

218. See *supra* note 86 and accompanying text.

219. See *supra* Part IV.C.2 (identifying the CRA as the most effective tool for abusive practices).

220. See *supra* notes 165-66 and accompanying text.

221. See *supra* Part I.B.

222. See discussion *supra* Part III.C.2.

223. See *supra* note 119.

224. See discussion *supra* Part IV.C.

225. See discussion *supra* Part III.C.2.

226. See discussion *supra* Part IV.C.